November 12, 2019

GRAND CANYON UNIVERSITY

RESPONSE TO DEPARTMENT OF EDUCATION APPROVAL OF GCU'S CHANGE IN CONTROL AND ANALYSIS OF DEPARTMENT OF EDUCATION'S DETERMINATION THAT IT WILL NOT TREAT GRAND CANYON UNIVERSITY AS A NONPROFIT FOR PURPOSES OF TITLE IV, HEA PROGRAMS

PREAMBLE

Grand Canyon University has prepared the following statement in response to a letter issued by the Department of Education regarding GCU's transaction of July 1, 2018, to revert to its historical status as a nonprofit university.

The University appreciates the Department of Education's approval of its change in control application and the issuance of a provisional program participation agreement through September 30, 2022, but it was surprised and disappointed by the Department of Education's position regarding the University's nonprofit status. The University believes the Department made critical errors in its understanding of the facts and its application of the law in reaching its conclusion on this important decision. Many of the errors in the Department's analysis could have been avoided if it had been willing to discuss the application with the University at any point since the initial application was filed in January 2018. Instead, despite repeated requests, the Department has been unwilling to have any meaningful discussions with the University over the past 22 months. As a result, the University strongly believes the Department reached the wrong conclusion on its nonprofit status and is reviewing its options to challenge this decision.

The University is hopeful that the disagreements it has with the Department on this topic can be resolved promptly with professional, productive discussions with the Department, and the University is willing to work cooperatively with the Department if there is any reasonable opportunity to do so.

Perhaps most disappointing, however, is the Department's failure to acknowledge the accomplishments that have occurred at GCU, both before and since the transaction closed – from an institution that was on the verge of closing more than a decade ago, to one that today is extremely important to the City of Phoenix, the State of Arizona and hundreds of thousands of students and alumni across the world. By the Department's own metrics, GCU has been a resounding success story, with the University's most recent cohort loan default rate of 5.6% for the 2016 cohort (the latest year for which data is available), well below the national average of 10.1%, no failing programs under the former gainful employment rules, and a 90/10 calculation of 72.91% for the year ended June 30, 2019, well below the Department's 90% requirement. The University has also invested over $1.5 billion back into the development of educational infrastructure over the last 10 years. And, all of this has been accomplished without raising tuition on the University's ground campus for 12 straight years and with only nominal 1% annual increases in online tuition over the last 10 years. As a result, after institutional scholarships, students attending the University's traditional campus pay on average only $8,700 per year in tuition. Average room and board costs at GCU ($8,038) are also well below the national averages for public four-year schools ($11,510) and private, nonprofit four-year universities ($12,990), according to the College Board, as the University is intent on making private Christian education affordable to all socioeconomic classes of Americans. The University's students graduate with less debt on average ($18,750 according to the latest College Scorecard data) than at public and private nonprofit universities ($28,650 according to 2017 data from

the Institute for College Access & Success). A tremendous benefit of the University's low cost of attendance is that the University has created one of the most diverse student bodies in the country with its ground campus student body consisting of 47% students of color, including 29% Hispanic and 7% African-American.

None of the foregoing could have been accomplished without the tremendous efforts of the thousands dedicated students, faculty, staff and alumni who have poured themselves into the transformation of GCU to create one of the greatest higher education success stories this country has ever seen. For that, the University wants to recognize your efforts and thank you for your hard work and dedication to Grand Canyon University. The University's future has never been brighter and, together, the GCU community looks forward to the even greater accomplishments that lie ahead for this remarkable University.

RESPONSE

By letter dated November 6, 2019 (the "Decision Letter"), the Department of Education (the "Department") approved the July 1, 2018 change in ownership transaction (the "Transaction") in which Grand Canyon Education, Inc. ("GCE") sold Grand Canyon University to an Arizona nonprofit corporation (in this document, Grand Canyon University and its Arizona nonprofit corporation owner are referred to jointly as "GCU" or the "University"). As a result of the approval, the Department awarded GCU a provisional program participation agreement ("PPPA") that permits the University to participate in Title IV, HEA programs through September 30, 2022. The Department awarded the PPPA without any requirement to post a letter of credit or any growth restrictions or other conditions. The Department's approval of the Transaction is significant – it means that there will be no disruption to students and that the University will be allowed to continue to operate as it has for many years, both before and after the Transaction.

The University disagrees, however, with the Department's position that the University does not satisfy the Department's definition of a nonprofit entity and, as a result, will continue to be treated as a proprietary entity for purposes of its participation in Title IV, HEA federal student aid programs.

Like all other private, nonprofit universities in the United States, GCU is a nonprofit corporation under the laws of its state of organization, and the Internal Revenue Service ("IRS") has determined that GCU qualifies as a tax-exempt educational organization under Section 501(c)(3) of the Internal Revenue Code ("IRC").[1] In its decision approving the Transaction, the Department acknowledges both that GCU has the legal authority under Arizona law to operate as a nonprofit organization and that GCU has been granted 501(c)(3) status by the IRS; however, the Department nevertheless determined that GCU "*does not satisfy the Department's definition of a nonprofit*" and, thus, concluded that the Department, contrary to the State of Arizona and the IRS, would continue to treat GCU "*as a for-profit institution for purposes of its participation in Title IV, HEA programs*." The Department's position is plainly at odds with these existing nonprofit determinations by state and federal agencies that are specifically authorized to make such determinations. The University is reviewing its options for challenging the Department's determination on this issue.

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[1] As the IRS notes on its website: "State law governs nonprofit status, which is determined by an organization's articles of incorporation or trust documents. Federal law governs tax-exempt status."
See https://www.irs.gov/charities-non-profits/before-applying-for-tax-exempt-status

The decision of the Department to continue to treat the University as a proprietary institution for Title IV, HEA program purposes does not affect the University's operations or its students, nor does it affect the University's right to identify itself as a 501(c)(3) tax-exempt organization like its private, nonprofit university peers. It only means that the University will need to continue to comply with certain heightened regulatory requirements which, as can be seen from the above-described metrics, have never been an issue for the University and were not a factor in the University's decision to return to its historical nonprofit status.

The Department has informed GCU that it intends to make the Decision Letter publicly available. It also offered GCU the opportunity to request that various portions of the Decision Letter be redacted. The University advised the Department that it would not request any redactions to the Decision Letter and asked that it be released in full.

The Decision Letter omits any description of the massive efforts GCU undertook to analyze and plan the Transaction, to establish and support GCU's status as a nonprofit organization, and to ensure that, if consummated, the Transaction and GCU's resulting status would benefit GCU and its students, faculty, staff and alumni. These efforts included engaging an independent tax advisor (PwC) and an independent legal advisor (Nixon Peabody LLP) to guide GCU and its Board of Trustees through the 501(c)(3) application process, as well as an independent financial advisor (Wells Fargo Securities, LLC), an independent tax advisor (Deloitte LLP), two independent law firms (Gallagher & Kennedy and Cooley LLP), independent real estate advisors, independent appraisers and others to guide GCU and its Board of Trustees through the Transaction process. The Decision Letter also fails to describe the extent to which GCU sought to engage with the Department over several years regarding the Transaction. GCU made extensive efforts to advise the Department in advance of its intention to proceed with the Transaction and to keep the Department well-informed regarding the details of, and the proposed timetable for, the Transaction, including promptly responding to multiple additional requests for information and offering to make its representatives available for meetings and consultations, to which the Department did not respond. As a result, the Decision Letter is replete with errors that easily could have been avoided, ignores information provided by GCU to the Department, and, among other things, fails to credit the extensive and substantive review of the Transaction conducted by GCU's accreditor, the Higher Learning Commission, during its approval process. Instead, the Department of Education has chosen to substitute its judgment regarding the application of the relevant tax law for that of the United States federal agency responsible for administering and interpreting the Internal Revenue Code.

The Department notes in the Decision Letter that GCU received its 501(c)(3) determination letter "three years prior to the Transaction," that "there is no evidence that the IRS conducted a comprehensive review" of the Transaction or supporting materials, and that "[u]nlike the IRS's initial grant of tax-exempt status, the Department's determination of nonprofit status considers the structure and planned operations of the Institution…." These statements appear to be the Department's way of indirectly stating, as others have publicly, that the IRS "rubber stamped" its decision to grant GCU tax-exempt status and failed to conduct an in-depth review of this Transaction. But, this is not true. GCU's 501(c)(3) application fully detailed the "structure and planned operations" of the University. Furthermore, in contrast with the Department's refusal to speak with GCU, during the period when GCU's 501(c)(3) application was under review and thereafter in connection with further efforts to structure the relationship between GCE and GCU, GCU and its tax advisors engaged in multiple discussions with IRS staff and modified various elements of the deal structure (including, in particular, various aspects of GCU's governance structure) to satisfy IRS requests. In addition, the Department purports to prohibit the University from referring to its "nonprofit status" in its advertising materials while at the same time

acknowledging that GCU is legally authorized to operate as a nonprofit corporation and has been granted status as a Code Section 501(c)(3) tax-exempt organization. This attempt by the Department to prohibit GCU from accurately describing its legal status in its commercial communications seems constitutionally questionable.

GCU strongly believes that the Department's decision cannot be supported on the merits. ***As is apparent to anyone that pays any attention or has ever been to GCU's campus, and as detailed below, GCU is an outstanding university that has a very positive record of service to its students, faculty, staff and alumni. After the Transaction, GCU has continued to enhance that positive record and is well positioned to continue on that path*****.** Accordingly, while GCU considers the appropriate path to challenge the Department's interpretation of its nonprofit status, GCU is issuing this detailed statement outlining some of the inaccuracies and faulty logic applied by the Department in its Decision Letter.

I. Background of the Transaction

On January 18, 2018, in connection with GCE's proposed sale of the University to GCU, GCU voluntarily filed a request for pre-acquisition review of the Transaction with the Department seeking the Department's review of the proposed Transaction and guidance as to any regulatory limitations, such as a letter of credit or growth restrictions, that the Department might choose to impose on GCU following the closing of the Transaction. While GCU sought ongoing engagement with the Department about the Transaction throughout the ensuing months, the Department failed to respond timely to the request, even though the change in control applications of other universities who engaged in similar transactions were approved. However, based on this limited engagement and a number of other factors, including the historical financial strength and performance of GCU, the importance to GCU of completing the transaction and reverting to its historical nonprofit status, and advice from the outside counsel to GCE and GCU about the risks involved in closing the transaction prior to receiving the Department's feedback, the Board of Directors of GCE and the Board of Trustees of GCU separately concluded, after more than five months of waiting for the Department to respond, that the benefits of consummating the Transaction at that time were numerous and any regulatory limitations imposed by the Department could be managed (particularly since GCU's regional accreditor, the HLC, and the Arizona state regulator had already approved the Transaction). Accordingly, the parties closed the Transaction on July 1, 2018. Since that time, GCE has since operated as a services provider to GCU and, following its acquisition of Orbis Education in January 2019, to 21 other university partners, while GCU has operated as an independent, private university, accorded nonprofit status by the State of Arizona and status as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code by the IRS.

II. GCU's October 1, 2018 Letter (the "GCU Letter").

Following the closing of the Transaction, in a letter to GCU, dated September 10, 2018, the Department requested that GCU provide support for why it should be treated as a nonprofit entity for Title IV, HEA program purposes. In an October 1, 2018 letter to the Department (the "GCU Letter"), GCU provided a comprehensive response in which it fully addressed the Department's request and covered many of the same topics reviewed by the Department in the Decision Letter. The Department, however, never responded to the GCU Letter, never followed up on any questions or issues with GCU regarding the issues the Department has now raised in the Decision Letter, and seemingly ignored the substance of the letter in reaching the conclusions set forth in the Decision Letter.

GCU believes the GCU Letter provides significant background information regarding the Transaction and makes a compelling case for treating GCU as a nonprofit entity for Title IV, HEA program purposes. Today, we are publicly releasing the GCU Letter and it is attached in its entirety as Exhibit A to this statement.

III. GCU's Response to the Department's November 6, 2019 Letter.

In addition to its release of the GCU Letter, in the pages that follow, GCU provides its additional responses to various portions of the Decision Letter that it believes are inaccurate, misinformed, or lacking in support. In certain instances, the responses borrow from the GCU Letter.

The Decision Letter (page 1)

"GCU seeks approval of its change in ownership and request to convert to nonprofit status for purposes of its participation in Title IV, HEA programs. Although the parties had requested the Department to conduct a pre-acquisition review, the Transaction closed on or about July 1, 2018, prior to completion of the Department's pre-acquisition review. This letter constitutes the Department's post-closing decision on the change in ownership ("CIO") and requested change of status from proprietary to nonprofit."

GCU's Response:

GCU believes that the statement above, while accurate, does not credit the extensive efforts undertaken by GCU to seek engagement with the Department regarding the Transaction. To summarize:

- Beginning as far back as 2011, GCU periodically engaged with the Department regarding its desire to return to non-profit status.
- In 2014, GCU publicly announced an effort to convert to non-profit status. This effort terminated in 2016 when its request for approval of the Transaction was denied by HLC based on HLC's then existing guidelines regarding the permissibility of services agreements between accredited universities and outside service providers.
- In 2017, the HLC changed its guidelines regarding the permissibility of services agreements and invited GCU to reapply for approval of the Transaction. GCU submitted its updated application to the HLC in August 2017.
- In January 2018, GCU filed its pre-acquisition review application with respect to the Transaction with the Department.
- From that filing to the closing of the Transaction on July 1,2018, GCU made substantial efforts to keep the Department well-informed regarding the details of, and the proposed timetable for, the Transaction, including promptly responding to multiple additional requests for information and offering to make its representatives available for meetings and consultations.

- During that period, GCU obtained approval for the Transaction from HLC, in early March 2018, and from its state regulator, the Arizona State Board for Private Postsecondary Education, in April 2018, each of which were promptly provided to the Department. HLC typically requires transactions to close within 30 days of its grant of approval, but GCU obtained HLC's authorization to extend the time for closing until the end of June 2018 in hopes that it would receive a response from the Department to its pre-acquisition review application by that date. On several occasions, the Department informally indicated to GCU's representatives that GCU could receive a response to its application in May 2018, but the only official communication that GCU received was a supplemental document request on May 17, 2018, to which GCU promptly and thoroughly responded.

- With no further contact from the Department and no indication as to when its review would be completed, GCU and GCE, and their respective boards, were forced to decide whether to continue to delay closing the Transaction without any information as to how long that delay could last (and potentially placing in jeopardy previously received approvals from HLC and other agencies), or to proceed with the closing and commence the Department's post-closing review process without a response to GCU's pre-acquisition review application.

- In this regard, GCU and GCE considered the significant costs already incurred and the additional costs that would be incurred if the Transaction was further delayed, as well as the monumental efforts undertaken to effect the Transaction. These efforts included, among other things, the transition from GCE to GCU of nearly 7,500 employees, as well as real estate, improvements, and other assets valued at over $1.0 billion; the establishment of insurance, benefits programs and policies to govern and support GCU and its employees; and the establishment of separate email and communication systems for the 2,500 employees remaining with GCE. In light of these considerations, the boards determined that certainty was in the best interests of GCU and GCE and that the benefits of closing the Transaction on July 1, 2018 outweighed the potential risks of doing so prior to receiving the Department's response. GCU and GCE therefore closed the Transaction on July 1, 2018, without receiving a response from the Department to the pre-acquisition review application.

- Following the closing, GCU received an additional document request from the Department dated July 3, 2018, to which the parties promptly responded on July 10, 2018. GCU also timely filed substantial supporting documentation with the Department as required on August 31, 2018, including all final agreements between the parties, an audited same-day balance sheet[2], and multiple independent valuation reports of the school assets.

- On September 10, 2018, GCU received a request from the Department to provide support for why it should be treated as a nonprofit entity for Title IV, HEA program purposes. GCU responded in the GCU Letter submitted on October 1, 2018.

Despite all of the work that went into the Transaction, and the numerous efforts GCU made to engage with the Department regarding the Transaction from early 2018 on, the Department never substantively engaged with GCU. Instead, with no advance warning and no discussion of any substantive issues with GCU over a nearly two-year period, the Department issued the Decision Letter

[2] This GCU balance sheet met the financial tests that the Department applies in the context of a change in control transaction, further reinforcing that GCU is in strong financial health after the Transaction.

- more than 22 months after the pre-acquisition review application was filed, more than 16 months after Transaction closed, and more than 13 months after GCU substantively responded to the Department regarding the nonprofit issue. *Please see Section III, beginning on page 3, of the GCU Letter attached as Exhibit A, for a further description of the extensive review of the Transaction, and GCU's nonprofit status, made by other governmental bodies.*
<u>The Decision Letter (p. 4)</u> *"The Department was provided with several reports (the "Reports") and valuations that were commissioned to support the Transaction, including reports from Barclays Capital Inc. ("Barclays") and Deloitte Tax, LLP ("Deloitte)."*
<u>GCU's Response:</u> The Decision Letter strongly implies that GCU based its decision to pursue the Transaction on advice received from Barclays and Deloitte. In fact, GCU did not engage Barclays as its financial advisor on the Transaction, did not review Barclays report, and had no interaction with Barclays on any matter. Instead, Barclays acted as financial advisor to <u>GCE</u> in the Transaction. It is unclear why the Department relies on the Barclays report as part of its analysis when it played no role in GCU's evaluation and approval of the Transaction. GCU did engage Deloitte to provide the transfer pricing analysis. It also engaged: an independent tax advisor (PwC) and an independent legal advisor (Nixon Peabody LLP) to guide GCU and its Board of Trustees through the 501(c)(3) application process, as well as an independent financial advisor (Wells Fargo Securities, LLC), an independent tax advisor (Deloitte LLP), two independent law firms (Gallagher & Kennedy and Cooley LLP), independent real estate advisors, independent appraisers and others to guide GCU and its Board of Trustees through the Transaction process. To ensure that a nonprofit organization does not violate the private inurement rules of the IRS, it must ensure that the payment for services received are at or below fair market value. The Deloitte transfer pricing analysis provides full support for the payments made to GCE for the services provided. Despite having access to this information regarding the extensive efforts made by GCU and its Board of Trustees to seek appropriate advice regarding the Transaction, the Department fails to mention any of this. The Department's reliance upon materials provided to GCE by GCE's financial advisor in determining GCU's nonprofit status is completely misplaced – which is frustrating given the amount of time it had to review the materials and its open invitation to discuss the Transaction with GCU if it ever had any questions about any aspect of the Transaction or supporting documents. Again, if the Department had simply engaged with GCU on this matter, this fundamental mistake could have easily been avoided.
<u>The Decision Letter (p.5)</u> *"The Barclays Report provides a side-by-side comparison of the Institution's operating costs in 2019 based on two different assumptions — (1) GCE continues to own the Institution and incurs the costs to operate the Institution or (2) the Transaction closes, and Gazelle is required to hire GCE to perform some of the operational activities. See Barclays Report at 33. The comparison shows that under the planned separation (and as effectuated on July 1, 2018) the costs to operate the separated Institution*

increase from $810 Million to $1.496 Billion for fiscal year 2019, solely as a result of the Service Fees paid to GCE."

GCU's Response:

The Department goes to extensive lengths in the Decision Letter to portray the Transaction as financially detrimental to GCU. In doing so, it makes mathematical errors and incorrectly interprets the financial models provided. It also fails to acknowledge that GCU, both before and after the Transaction, has been a higher education success story that is in excellent financial condition on a standalone basis.

As an example of the types of errors in the Decision Letter, the quote above references the Department's assertion that GCU, as a result of the Transaction, incurred operating costs of $1.496 billion. However, the $1.496B figure referred to in the Barclays report is a hypothetical "consolidated" expense figure that combines the projected operating expenses of ***both*** GCE and GCU post-Transaction, and it includes the projected annual revenue share payment from GCU to GCE, which cannot fairly be designated as an operating cost of GCU. In other words, GCU's true operating expenses (overhead required to generate revenue) did not increase at all as a result of the Transaction – rather, those combined costs were split between GCU and GCE just as revenues are split. The fact that GCU receives 100% of the revenue in the first instance and then remits 60% to GCE does not create any actual additional expenses.

In fact, the Barclays analysis shows that, on a consolidated basis, assuming the Transaction did not occur, GCE/GCU would earn $254 million in net income for fiscal year 2019, and that, on a separated basis, the two entities would earn a combined $271 million. Thus, the net income of the parties, as a result of the separation, actually increased primarily owing to reduced real estate tax and stock-based compensation.

The expected beneficial impact of the Transaction to GCU was well-understood by the HLC, GCU's accreditor, which noted in its report on the Transaction:

"The updated application and financial model shows that . . . . [GCU]'s revenues would be more than sufficient to fund its projected expenses including the fees due under the MSA, as well as interest payments that would be required to be made on the note (in connection with the purchase agreement)."

More broadly, the HLC's analysis has been confirmed in the time since the Transaction closed. GCU's revenue net of expenses and revenue net of expenses after interest for the year ended June 30, 2019, its first fiscal year of operations as a stand-alone tax-exempt educational institution, were $78.8 million and $26.1 million, respectively. In addition, for the year ended June 30, 2019, GCU generated over $123 million in operating cash flows and, as of June 30, 2019, held over $325 million in cash reserves. It also owns a nearly-300 acre campus and educational assets that have an excess value of approximately $360 million over the purchase price it paid GCE for those assets. Overall, the University is in a very strong financial position.[3]

[3] When GCU files its audited financial statements for the year ended June 30, 2019, those statements again will show that the University is in sound financial health with a passing financial composite score under the Department's measurements.

<u>The Decision Letter (pages 4-9)</u> *The Department's analysis on pp. 4-9 of the Decision Letter focuses almost entirely on how **GCE** may have analyzed the Transaction and how the Transaction may have benefitted **GCE**. Yet, the Decision Letter fails to include any analysis, or even any reference, to the process undertaken by GCU and its Board of Trustees, or the advice and counsel that GCU and its Board of Trustees received from their own independent advisors.*
<u>GCU's Response:</u> The Department's focus on GCE's analysis of the Transaction gives the false impression that GCE structured and approved the Transaction by itself. As has been voluminously disclosed in public filings and in GCU's filings with the Department, GCU has its own independent Board of Trustees and engaged its own independent financial, legal, tax, accounting and other professional advisors to guide it through the Transaction. Over the course of the roughly three-year period during which the parties sought to effect the Transaction, the GCU Board of Trustees met seventeen times to review the Transaction. With the help of its own independent advisors, the GCU Board of Trustees applied for and obtained the 501(c)(3) determination letter; analyzed the Transaction terms, the deal documents (including the Services Agreement), other services agreements in the industry, and the impact of the Transaction on the University's financial condition and projected future financial performance; and also analyzed the impact of the Transaction on GCU's faculty, staff, student body, alumni and surrounding community. In the end, the GCU Board of Trustees independently determined that consummating the Transaction was in the best interests of the University and its students, faculty, staff and alumni. For reasons that remain unclear, the Department purposely chose not to reference any of this or the countless hours of hard work undertaken by the GCU Board of Trustees and its advisors in completing this Transaction. The Department cannot fairly analyze the Transaction as it relates to GCU without discussing the steps that GCU and its Board of Trustees took in evaluating and ultimately approving the Transaction. The Department's omission of this information defies explanation. As to the analysis of the Transaction from GCE's perspective -- which as noted is detailed at length in the Department's letter -- it is not surprising that GCE's management and board of directors received advice from their financial advisor regarding the benefits that the Transaction could provide to GCE. The determination by GCE's board of directors that the Transaction was in GCE's best interests does not mean that the Transaction was not also in GCU's best interests. These two perspectives are not mutually exclusive. The Department is simply ignoring the determination by the GCU Board of Trustees that this Transaction was, and continues to be, in the best interests of GCU's students, faculty, staff and alumni.
<u>The Decision Letter (pages 6-9)</u> *"Significantly, Deloitte did not identify the Institution's physical campus as revenue-generating, which is at odds with statements made by GCE to its shareholders. Notwithstanding the campus facilities' undeniable contribution to revenue, Deloitte did not consider it as a revenue-generating asset."* *"…because the Deloitte Report failed to identify the Institution's campus as a revenue-generating asset, it failed to consider the fact that Gazelle is incurring significant fixed-cost risk in connection with*

the campus. Gazelle owes a lump sum payment to GCE on July 1, 2025 of $853,068,386, which represents the purchase price for the campus."
<u>GCU's Response:</u> In fact, Deloitte did identify the physical campus as revenue generating. The Department's confusion here appears to stem from Deloitte's identification and discussion of 7 "key departments" within the pre-Transaction organization that were "value creating drivers" for the University. *Id.* at p. 19. The Department's misunderstanding of Deloitte's analysis is made clear by its statement that "Deloitte found that the Institution generates revenue from seven activities," when it was not activities but personnel departments that Deloitte identified as driving value. This statement leads up to the erroneous statement that Deloitte did not consider the campus as revenue-generating, which gives the impression that the Department inferred this belief from the fact that Deloitte did not include the physical campus as one of the seven activities. The Department's contention that Deloitte failed to consider the campus as a significant fixed-cost risk to GCU also indicates the Department's misunderstanding – not only did Deloitte identify the campus as revenue-generating, but all parties involved (including financial advisors for both sides) were aware that the physical campus assets were being sold to GCU at below market value. In fact, the value of the campus and other educational assets acquired by GCU in the Transaction was $360M more than the purchase price, which greatly mitigated any risk to GCU in this regard. Again, the Department could have avoided this critical mistake if it had simply engaged with the University prior to issuing its Decision Letter.
<u>The Decision Letter (p. 9)</u> *"It also bears mentioning that the main opinions in the Deloitte Report do not appear to be based on information that Deloitte independently tested and analyzed on behalf of Gazelle. Rather, those opinions in key areas appear to have been based on information supplied by GCE management. For example, Deloitte states that it identified revenue-generating activities based on 'fact finding discussions with key management personnel,' that the classification of fixed costs was made "in conjunction with GCE management," and that the calculation of the share of fixed costs Gazelle and GSA would each pay under the MSA was determined by 'Deloitte Tax and GCE.'"*
<u>GCU's Response</u>**:** As the Department well knows, prior to the closing of the Transaction, Gazelle was a newly formed nonprofit corporation. While it had an independent Board of Trustees, and had been granted 501(c)(3) tax exempt status by the IRS, it did not have any employees *because it did not yet own the University*. Thus, prior to the Transaction, all employees of the University were employed by GCE and all information provided by management necessarily was provided by GCE management (which included academic management that would ultimately transfer to GCU).[4] Deloitte, however, was engaged by GCU's independent Board of Trustees, not GCE, and the Deloitte report was issued to and

[4] Upon the closing of the Transaction, approximately 1,500 faculty, admission, staff and other employees, along with 6,000 part-time employees, transferred employment to GCU.

reviewed by GCU's independent Board of Trustees and its independent financial and legal advisors in connection with their review of, and decision to approve, the Transaction.

<u>The Decision Letter (p. 9 and p. 15)</u>

"Because Gazelle seeks to participate in Title IV, HEA programs as a nonprofit institution, it must meet the Department's requirements for that status. The Higher Education Act ("HEA") defines an institution of higher education as "a public or other nonprofit institution." HEA §101(a)(4), 20 U.S.C. §1001(a)(4); HEA §102(a)(l), 20 U.S.C. §1002(a)(l). The Department regulations define a nonprofit institution as an institution that:

(i) Is owned and operated by one or more nonprofit corporations or associations, no part of the net earnings of which benefits any private shareholder or individual; and

(ii) Is legally authorized to operate as a nonprofit organization by each State in which it is physically located; and

(iii) Is determined by the Internal Revenue Service to be an organization to which contributions are tax deductible under 26 U.S.C. §501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)).

34 C.F.R. §600.2. 14"

"Based on the tax authority cited above, the Department has determined that GCU does not meet the operational test's requirement that both the primary activities of the organization and its stream of revenue benefit the nonprofit itself. Rather, the materials that the Department has reviewed demonstrate that GCE and its shareholders — rather than Gazelle/GCU -- are the primary beneficiaries of the operation of GCU under the terms of the MSA. This violates the most basic tenet of nonprofit status — that the nonprofit be primarily operated for a tax-exempt purpose and not substantially for the benefit of any other person or entity."

<u>GCU's Response:</u>

In Section III of its Letter, the Department analyzes its requirements for nonprofit status relating to participation in Title IV, HEA programs. In doing so, the Department cites to its regulatory definition of a nonprofit institution found in 34 C.F.R. 600.2. This three-prong test is succinct – roughly 80 words – and appears to comprise the entirety of the Department's regulatory basis for whether an institution qualifies for nonprofit status. In analyzing the definition, the Department acknowledges that GCU satisfies the "owned and operated by one or more nonprofit corporations" requirement of prong (i) of the definition and that GCU also satisfies prongs (ii) and (iii) of the definition, such that the sole issue as to GCU's qualification is "*whether its net earnings benefit any private shareholder or individual*" (this is often referred to as the "Private Inurement Test"). The Department states that the determination as to whether the Transaction satisfies the Private Inurement Test requires a further review of "relevant authority under the Internal Revenue Code.". The Department then provides two pages of detailed analysis of IRS statutes, IRS private letter rulings, and tax decisions of the Federal courts before concluding that "based on the tax authority cited above, the Department has determined that GCU does not meet the *operational test's* requirements that both the primary

activities of the organization and its stream of revenue benefit the nonprofit itself." This conclusion, however, does not address the Private Inurement Test, but rather addresses the so-called "operational test" (the "Operational Test"). The Operational Test, while it includes a judicially imposed private benefit prohibition, is different than the Private Inurement Test and actually is subsumed within prong (iii) of the Department's definition above. In other words, when conceding that GCU satisfies prong (iii) of the definition of "nonprofit institution," the Department has thus conceded (i.e. by its own regulation, it has deferred to the IRS's determination) that GCU satisfies the Operational Test. It is unclear on what authority the Department relies to substitute its judgment regarding the Operational Test for that of the IRS, nor is it clear why the Department of Education believes that it has the ability to interpret tax law better than the IRS.

Because the IRS is the agency tasked with determining an entity's 501(c)(3) tax exempt status, GCU believes that the IRS's determination that an institution qualifies as a 501(c)(3) tax exempt entity (and, by definition, satisfies the Operational Test) should be given appropriate deference by the Department in making its decision. Indeed, GCU believes that the Department's very own regulations mandate this deference.

Code Section 501(c)(3) imposes several requirements in order to qualify as a tax-exempt organization. The Private Inurement Test is just one of those requirements. The other requirements are that (i) the organization be "organized and operated exclusively" for a tax-exempt purpose (e.g., educational, charitable, religious, etc.) (which incorporates the Operational Test), (ii) no substantial part of the activities of the organization include legislative activities; and (iii) the organization not participate in any political campaign. If the authors of the Department's regulations wanted the Department to be able to substitute its judgment for that of the IRS on these other three requirements, including on the Operational Test, then they could have easily done so in the Department's regulations. Had they done so, then prong (iii) of the Department's definition of "nonprofit institution," which cedes to the IRS the authority to determine the elements of tax-exempt status set forth in Code Section 501(c)(3) other than the Private Inurement Test, would have obviously been superfluous. Alas, they didn't. Instead, the only requirement from Code Section 501(c)(3) over which the Department reserved judgment is the Private Inurement Test.

In its application, the focus of the Private Inurement Test is limited to private shareholders and individuals and courts have interpreted the test to apply to insiders, such as founders, directors, and officers. Given that the only Code Section 501(c)(3) requirement over which the Department has explicit authority in its own definition of "nonprofit institution" is the Private Inurement Test, one would have expected that there would have been an extensive analysis by the Department of GCE's role as an insider of GCU. Yet, there is absolutely none, likely because it is clear that GCE is not an insider of GCU – it has no ownership interest in GCU and there is no overlap between GCE's Board of Directors and GCU's Board of Trustees – and the Department knows that GCE is not an insider of GCU. Instead of engaging in the proper analysis, the Department takes an unfathomable leap in its authority to substitute its judgment for that of the IRS's regarding the Operational Test. The Department's very own regulations clearly do not give it the authority to substitute its judgment for the IRS's on this Code Section 501(c)(3) requirement.

Moreover, even if the Department had the authority to determine whether GCU satisfied the Operational Test and to determine whether there was a prohibited private benefit under that test, there is clearly none. Except for the three principal transaction documents – the APA, the Credit

Agreement, and the MSA – and a Facilities Services Agreement, copies of which were provided to the Department, there are no other agreements between GCU and GCE.

- GCU acquired all of the land, buildings and personal property that comprise the GCU campus and has complete control over those assets. The GCU campus today consists of more than 270 acres in the heart of Phoenix, with classroom facilities, a library, administration buildings, dormitories, parking structures, a performing arts center, recreational and NCAA athletic facilities, and other improvements, nearly all of which have been built in the last eight years at a cost of more than $1.0 billion. GCU's Board of Trustees hired third party appraisers who valued this property at approximately $360 million more than the purchase price it paid GCE for those assets.

- The financing terms negotiated and agreed to under the Credit Agreement reflect a straight debt obligation with a fixed interest rate within a range recommended by an independent third party and other customary commercial terms modeled on GCE's existing market-based credit agreement. Neither the interest rate, nor the principal balance of the note, change based on the profitability of GCU. In addition, GCU's Board of Trustees hired its financial advisor, Wells Fargo Securities, LLC, to provide a range of interest rates that it believed was fair market value for similar debt. The interest rate agreed to was at the midpoint of that range.

- The revenue share rate under the MSA was negotiated and agreed to in large part based on the transfer pricing study that GCU's Board of Trustees engaged Deloitte to perform and does not change based on the profitability of GCU. GCU's Board of Trustees and Deloitte also looked at similar service agreements that had been entered into between service providers and nonprofit universities and concluded that, under the Services Agreement, GCU is paying a revenue share rate for the services that it is receiving that is below fair market value.

- The revenue net of expenses and revenue net of expenses after interest of GCU for the year ended June 30, 2019, its first fiscal year of operations as a stand-alone tax-exempt educational institution, were $78.8 million and $26.1 million, respectively. ***All of those earnings are for the benefit of GCU, and GCU's Board of Trustees alone has the authority to determine how GCU's earnings are utilized.***

We believe the foregoing amply demonstrates that GCU, both on paper and in fact, satisfies the definition of a nonprofit institution.

<u>The Decision Letter (p.15)</u>

"GCU's IRS approval 'was issued three years prior to the Transaction' and 'there is no evidence that the IRS conducted a comprehensive review of the MSA or any of the studies that were later performed to support the MSA.'"

<u>GCU's Response:</u>

During 2015, GCU filed a Form 1023 with the IRS and sought a determination that it was qualified under Section 501(c)(3) of the Internal Revenue Code to operate as a nonprofit university. The Form

1023 was filed specifically in contemplation of the proposed transaction with GCE and contained extensive details regarding the terms of the proposed transaction between GCU and GCE, including the terms of the proposed MSA and *the fact that Mr. Mueller would serve both as President of GCU and Chief Executive Officer of GCE*. In November 2015, the IRS issued its determination letter designating GCU as a tax-exempt educational organization pursuant to Section 501(c)(3) of the Internal Revenue Code. While GCU obtained this approval nearly three years prior to the completion of the Transaction, the basic structure of the transaction as described in the Form 1023 is not different from the terms of the Transaction as consummated on July 1, 2018, and the terms of GCU's governance structure, including Mr. Mueller's dual role, as well as the terms of the MSA, were described in detail. On August 31, 2018, at GCU's request, the IRS issued an affirmation letter confirming GCU's status as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code. A copy of the Form 1023, as filed with the IRS, the IRS determination letter, and the IRS affirmation letter were provided to the Department. The financial terms of the Transaction did change between the 2015 application and the closing of the Transaction on July 1, 2018. At the time of the 2015 application, the third party valuation and transfer pricing studies that GCU initiated for purposes of informing the pricing of the acquisition of GCU and the terms of the MSA had not yet been completed. However, GCU believes that the terms of the Transaction as closed on July 1, 2018, based on very recent valuation and transfer pricing studies, were more favorable to GCU than the terms that were anticipated in 2015. And the Department's conclusory statement that the IRS did not comprehensively review the proposed Transaction and related structure is simply not supported. As noted above, during the period when GCU's 501(c)(3) application was under review and thereafter in connection with further efforts to structure the relationship between GCE and GCU, GCU and its tax advisors engaged in multiple discussions with IRS staff and modified various elements of the deal structure (including, in particular, various aspects of GCU's governance structure) to satisfy IRS requests. Moreover, as noted above, other than the reference to the requirement that no part of the net earnings may benefit any private shareholder or individual, the Department's regulations explicitly defer to the IRS's determination whether the organization satisfied the other requirements of Code Section 501(c)(3).
<u>The Decision Letter (p.17)</u> *"Mr. Mueller, as the CEO of GCE, 'is the key executive responsible for providing the services under the MSA, with duties of loyalty to shareholders of GCE. Yet, as the Institution's President he will have responsibility to manage matters large and small with its primary service provider, notwithstanding the appointment of a Designee and the independent trustees who comprise the MSA Committee. Given those obviously conflicting loyalties, and the breadth of the services provided under the MSA, the Department is not satisfied that these structures are sufficient to ensure that Mr. Mueller's undivided loyalty is to the Institution.'"*
<u>GCU's Response:</u>

The Department's analysis of Mr. Mueller's dual role conflicts with the standards of the HLC, which permit overlapping management between a university and a service provider, contradicts the findings of the HLC that the governance structures in place are adequate and provide for independent governance of the University, and also is in contrast with the IRS' determination to grant GCU 501(c)(3) status after being fully informed of Mr. Mueller's proposed dual role. Given the HLC's far greater substantive interaction with GCU during its review process, which included a multi-day campus visit with live interviews with many relevant parties, we fail to see the basis for the Department's conclusion. It is also important to note that the decision to employ Mr. Mueller was made independently by both GCU's Board of Trustees and GCE's Board of Directors, each of which is fully independent of the other, with no overlapping members. Each board made its decision with full knowledge of his overlapping roles, based on a determination by each that he is the best person to lead their respective organization. In addition, the MSA, as well as GCU's bylaws and conflict of interest policy, all contain significant conflict of interest protections.

IV. Conclusion.

While the Decision Letter makes other errors, GCU believes that the above provides sufficient indication of the grave errors in the Department's response, especially in light of the obvious success of GCU over the years and in the 16 months since the Transaction closed.

Again, perhaps most importantly, GCU's success has been accomplished without the University raising tuition at its ground campus for 12 straight years, with tuition holding at $16,500 per year, and with only nominal 1% tuition increases for its online campus over the last 10 years. After institutional scholarships, students attending the University's traditional campus pay on average only $8,700 per year in tuition. Average room and board costs at GCU ($8,038) are also well below the national averages for public four-year schools ($11,510) and private four-year universities ($12,990), according to the College Board, as the University is intentional about making private Christian education affordable to all socioeconomic classes of Americans. The University's students graduate with less debt on average ($18,750 according to the latest College Scorecard data) than at public and private nonprofit universities ($28,650 according to 2017 data from the Institute for College Access & Success). A tremendous benefit of the University's low cost of attendance is that the University has created one of the most diverse student bodies in the country with its ground campus student body consisting of 47% students of color, including 29% Hispanic and 7% African-American.

The University continues to be a vital component of Arizona's higher education infrastructure, currently educating over 21,000 students on its ground campus and over 80,000 online. The University's campus is currently ranked No. 19 out of 1,417 universities in the country and its dorms are ranked No. 6 out of 1,384 universities in the country according to niche.com. The University offers over 220 degree and certification programs across nine colleges, with an accomplished student body having an average incoming GPA over 3.5 for each of the last four years, and an Honors College with over 2,000 students and an average incoming GPA of 4.1 in Fall 2019. As just one example of the demonstrated quality of the University's student body, graduates of the University's College of Nursing achieved a 91.5% first-time pass rate on the NCLEX professional nursing exam in calendar year 2018, with a 98.2% pass rate in the first quarter of 2019 and a 98.6% pass rate in the second quarter of 2019.

The University's success isn't limited to its campus alone. The University has partnered with its surrounding community to help transform one of the most impoverished communities in the City of

Phoenix. In particular, the University entered into a $1.6 million eight-year partnership with the City of Phoenix Police Department that has resulted in a 26.8% decline in property crimes (compared to a 3.8% drop citywide) and an 8.6% decline in violent crimes (compared to a 13% increase citywide) during the first 5 years of the program from 2012 to 2017. From a home value perspective, the University partnered with Habitat for Humanity to raise $2 million and contribute 21,000 volunteer hours to renovate more than 250 homes in its community, resulting in a 302% increase in home values for residents in the 85017 zip code since 2011. From a community education standpoint, the University created a groundbreaking Learning Lounge program that provides free tutoring and mentoring to more than 3,000 K-12 students at 150 neighboring schools in the last six years. As part of the Learning Lounge program, the University has awarded 262 full-tuition scholarships to low-income students who sought assistance in the Learning Lounge and had a demonstrated financial need. From a jobs perspective, in addition to the thousands of jobs created on its campus, the University has also launched several new business enterprises that provide management opportunities for recent graduates and employment opportunities for hundreds of current students and local residents.

On a combined basis, prior to the closing of the Transaction, over $1.5 billion had been invested into improvements in educational infrastructure for the benefit of students, through the development of the University's campus and technology. Subsequent to the closing of the Transaction, the University continues to invest in the growth and development of its educational infrastructure, including classrooms, dorms, and experienced, high-quality faculty, while simultaneously benefitting from GCE's continued investment in educational infrastructure, including the development of a new online learning management system that supports the learning experience for GCU students.

GCU's nonprofit articles of incorporation identify its primary purpose of operating for general educational purposes, including the conferring of academic degrees, diplomas, honors or certificates. Notwithstanding the Department's erroneous Decision Letter, GCU will not be deterred in the continued pursuit of its nonprofit purpose.

EXHIBIT A

OCTOBER 1, 2018 LETTER TO THE DEPARTMENT OF EDUCATION RE GCU NONPROFIT STATUS

(Attached)

Cooley

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October 1, 2018

Donna Mangold, Esq.
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U.S. Department of Education
400 Maryland Avenue, SW
Washington, DC 20202

Re: Pending Application of Grand Canyon University

Dear Ms. Mangold:

I am writing in response to your letter of September 10, 2018, with respect to the ongoing review by the U.S. Department of Education (the "Department") of the transaction by which the ownership of Grand Canyon University was transferred to a 501(c)(3) nonprofit organization so that it is now owned and operated by a nonprofit corporation.

I. <u>Relevant Parties</u>.

For purposes of this letter and to avoid confusion:

- Grand Canyon University ("GCU") is the accredited institution that was previously owned and operated by Grand Canyon Education, Inc., a Delaware corporation ("GCE"), and that was sold by GCE to a nonprofit entity originally incorporated as Gazelle University ("New GCU") in the transaction under review.

- New GCU—the 501(c)(3) nonprofit corporation that acquired GCU—was originally incorporated as Gazelle University, an Arizona nonprofit corporation. Upon the closing of the transaction, it changed its legal name to Grand Canyon University and is referred to in this letter as "New GCU."

- GCE is the publicly traded, for-profit entity that previously owned and operated GCU and that sold GCU to New GCU. GCE remains in existence as a for-profit entity operating as an educational services provider.

- The transaction by which New GCU acquired GCU from GCE, including the entry by the parties into an asset purchase agreement (the "APA"), a credit agreement (the "Credit Agreement") and a master services agreement (the "MSA"), is referred to as the "Transaction."

II. <u>GCU's Pre-Acquisition Review Application and Correspondence with the Department</u>.

As you are aware, GCU filed its pre-acquisition review application with the Department on January 18, 2018. From that filing to the present, including up to and throughout the closing of the Transaction, GCU made substantial efforts to keep the Department well-informed regarding the details of, and the proposed timetable for, the Transaction, including promptly responding to multiple additional requests for information and offering to make its representatives available for meetings and consultations. During that period, GCU

obtained approval for the Transaction from its institutional accreditor, the Higher Learning Commission ("HLC"), in early March 2018, and from its state regulator, the Arizona State Board for Private Postsecondary Education (the "Arizona Board"), in April 2018, each of which were promptly provided to the Department. HLC typically requires transactions to close within 30 days of its grant of approval, but GCU obtained HLC's authorization to extend the time for closing until the end of June 2018 in hopes that it would receive a response from the Department to its pre-acquisition review application by that date. On several occasions, the Department informally indicated to GCU's representatives that GCU could receive a response to its application in May 2018, but the only official communication that GCU received was a supplemental document request on May 17, 2018, to which GCU promptly and thoroughly responded.

With no further contact from the Department and no indication as to when its review would be completed (and understanding that Department personnel are operating under a substantial workload), New GCU and GCE, and their respective boards, were forced to decide whether to continue to delay closing the Transaction without any information as to how long that delay could last (and potentially placing in jeopardy previously received approvals from HLC and other agencies), or to proceed with the closing and commence the Department's post-closing review process without a response to GCU's pre-acquisition review application. In this regard, the parties understand that, under Department regulations, the decision to obtain a pre-acquisition review letter is optional and at the discretion of the institution. New GCU and GCE considered the significant costs already incurred and the additional costs that would be incurred if the Transaction was further delayed, as well the monumental efforts undertaken to effect the Transaction. These efforts included, among other things, the transfer from GCE to New GCU of nearly 7,500 employees, real estate improvements, and other assets valued at over $1.0 billion; the establishment of insurance, benefits programs, and policies to govern and support New GCU and its employees; and the establishment of separate email and communication systems for the 2,500 employees remaining with GCE. In light of these considerations, the boards determined that certainty was in the best interests of New GCU and GCE and that the benefits of closing the Transaction on July 1 outweighed the potential risks of doing so prior to receiving the Department's response. Closing on July 1, 2018, had the added benefits of enabling New GCU to begin its ownership of GCU on the first day of its fiscal year, giving its auditors the maximum time to prepare its audited opening day balance sheet, and allowing the two organizations to transition into the new operating structure before the start of GCU's fall semester when its student population is at its highest.

New GCU and GCE therefore closed the Transaction on July 1, 2018, without receiving a response from the Department to the pre-acquisition review application. Since closing, the parties have received an additional document request from the Department dated July 3, 2018, to which New GCU and GCE promptly responded on July 10, 2018. The parties also timely filed substantial supporting documentation with the Department as required on August 31, 2018, including all final agreements between the parties, an audited same-day balance sheet, and multiple independent valuation reports of the school assets.

III. <u>Extensive Review of the Transaction to Date</u>.

The Transaction and the plans for New GCU to own and operate GCU as a nonprofit institution have been thoroughly reviewed by other regulatory bodies. We understand that the Department makes an independent decision regarding an institution's status as a nonprofit institution for Title IV purposes, but we offer this as evidence of the fact that other government bodies and regulators, having scrutinized the Transaction for their own purposes, have concluded that it is appropriate to treat GCU as a nonprofit institution.

(a) ***HLC***. As you are likely aware, New GCU and GCE made an initial effort to effect a transaction during the 2014-2016 time period. The HLC staff, after a detailed review of the proposed transaction that included a multi-day site visit, recommended that the transaction be approved by the HLC

board. In March 2016, however, the HLC board denied GCU's application for approval of a substantive change for several reasons, but most notably HLC's view that its accrediting standards in effect at the time did not countenance the type of service relationship between institutions and third-party entities that was proposed by New GCU and GCE.

In the spring of 2017, HLC began to study new standards to govern its review and approval of service relationships between accredited institutions and third-party providers and, in May 2017, proactively invited GCU, if interested, to resubmit its application for a substantive change. GCU determined to move forward, and GCE and New GCU reengaged in the transaction process during the summer and fall of 2017, pending HLC's final adoption of the new standards. HLC adopted its new standards in November 2017, and after advance consultations with HLC on the proposed transaction structure (including a lengthy response to written questions from outside legal counsel engaged by HLC to determine whether the proposed structure complied with the new standards and addressed all concerns noted in the 2016 denial letter), GCU filed its updated application seeking approval of a substantive change with HLC on December 18, 2017. HLC staff once again reviewed GCU's application, the financial and other terms of the transaction documents (including the terms of the APA, Credit Agreement and MSA), the governance structure of New GCU, and GCU's post-closing plans in great detail. It is important to note that while the new HLC standards necessitated certain changes to the terms of the MSA (such as the inclusion of specific rights in favor of New GCU to audit GCE's performance of its services) that generally favored New GCU, these changes did not alter in any material respect the structure of the Transaction and the terms of the MSA from those initially proposed in GCU's 2014 application.

HLC's review of GCU's application focused on several issues relevant to the Department's review, including New GCU's governance structure and the terms of the MSA as they relate to New GCU's independent governance. On this subject, HLC scrutinized the identity of the members of the New GCU board of trustees, their relationships with one another and with GCE, the complete independence of the New GCU board and the GCE board from one another (there being no overlapping members), the proposed role of Mr. Brian Mueller as both president of GCU and chief executive officer of GCE (a dual role that he had held for more than six years), and the provisions of the MSA that ensure that GCU retains absolute control over all of its academic functions and decision making processes. On each point, HLC was satisfied and gave its approval, adopting the conclusions of the HLC staff in its Summary Report that formed the basis for the HLC board's decision. A copy of the Summary Report is attached hereto as <u>Exhibit A</u> and we list below several quotations included therein:

- With regard to GCU's mission (p. 6): "[T]here continues to appear to be good continuity in mission, academic programs, student enrollment, and faculty that will exist after the transaction takes place."

- With regard to governance (p. 8): "[A]ll evidence submitted indicates that [New GCU] will otherwise have an independent governing board (i.e., the Board of Trustees) that possesses and exercises the necessary legal power to establish and review the basic policies that govern the institution."

- With regard to New GCU's projected finances (p. 12): "The updated application and financial model shows that New GCU net revenue in FY18 will be approximately $1.1B with total operating expenses of approximately $900M. Net income will be approximately $22M. The financial model shows net income increasing significantly over the next 5 years. . . . New GCU's revenues would be more than sufficient to fund its projected expenses including the fees due under the MSA, as well as interest payments that would be required to be made on the note (in connection with the purchase agreement). The institution also

maintains that New GCU should have sufficient cash flow to fund the capital expenditures it continues to make to its ground campus to accommodate up to 28,500 (as projected in FY2024) and any other improvements it plans to continually make to its online infrastructure after the first two years post transaction."

- With regard to Mr. Mueller's dual role (pp. 13-14): "At the time of the 2016 HLC notification to the institution regarding its application, the HLC Board of Trustees had not yet addressed in its rules and policies any standards, applicable to its institutions with respect to the entering into and performing of shared serves arrangements, similar to Draft Master Services Agreement. GCU was informed, in a letter dated November 17, 2017, that at its meeting on November 2-3, 2017, the HLC Board of Trustees adopted new guidelines related to the determination and evaluation of shared services arrangements. The new guidelines apply to the examination and approval of the GCU's 2017 application for Change of Control, Structure, or Organization. In that regard, the new guidelines address a dual appointment by stating that "the institution may have overlapping senior executive leadership [with the service provider] who may have voting or non-voting positions on the institution's board. This arrangement is appropriate provided that a majority of the board of each organization is independent and decisions with respect to the appointment, hiring and retention of any overlapping executives are made by a majority of the independent directors of each institution.

  "GCE's Board of Directors is comprised of five members, four of which are independent members. Mr. Mueller, the Chief Executive Officer of GCE, is not independent. GCU currently has a separate institutional board of trustees comprised of five members and Brian Mueller, the President of GCU, is not independent.[1] New GCU will be comprised of the same board members that currently exist at GCU. Therefore, it appears that this arrangement would comply with the HLC's new guidelines.

  "Moreover, to avoid any conflict of interest, or apparent conflict of interest, the draft Master Services Agreement provides that Mr. Mueller is specifically excluded from any direct role in overseeing the relationship between GCE and GCU in connection with any services provided by GCE. Likewise, New GCU's amended and restated bylaws will provide for the establishment of an "MSA Committee," comprised of members of New GCU's Board of Trustees who are also free of any conflicts of interest with respect to GCE, to oversee the relationship. As referenced above, the dispute resolution process set forth in Section 18.11 of the draft MSA places responsibility for New GCU in the hands of the MSA Committee.

  "Finally, as noted, other than Mr. Mueller, there is no overlap or other relationship between the boards of New GCU and GCE. As stated in their respective organizational documents, each board possesses the customary fiduciary duties to oversee and manage its respective entity."

- With regard to New GCU's post-closing structure (p. 36): "Once the transaction has closed, the GCE stockholders will continue to retain ownership in the remaining publicly traded company, but any such ownership interests in GCU will be null and void. Grand Canyon University will continue to be operated by its existing Board of Trustees following the

[1] Subsequent to the HLC approval, Mr. Mueller and New GCU determined that, while acceptable to HLC, Mr. Mueller should not serve as a member of its board of trustees. Mr. Mueller resigned from that position in June 2018, prior to the final decision of the trustees to approve the Transaction.

transaction; likewise, the current management staff will continue to serve in their roles thus bring a solid background in higher education as well as a thorough understanding of GCU and its goals."

We hope the above highlights indicate to the Department the seriousness with which parties focused on governance and structure, and the extent to which the New GCU and GCE relationship differs from other "nonprofit conversions" that have come under Department scrutiny in the past.

The independent governance of New GCU has been demonstrated in its conduct since the closing of the Transaction on July 1, 2018. Since that date, the New GCU board has added three new and independent board members, who were vetted by the members of the board of trustees, again, all of whom are independent. Accordingly, the New GCU board now consists of seven members, and each of them is independent. GCE, as the former owner and ongoing service-provider, had no role whatsoever in these decisions.

(b) ***Arizona Board***. The Arizona Board conducted its own review and also approved the Transaction. In its approval letter, dated April 26, 2018, the Arizona Board specifically acknowledged that, upon the closing of the Transaction, it would recognize GCU as a nonprofit institution. A copy of the Arizona Board approval letter is attached as Exhibit B.

(c) ***Internal Revenue Service***. During 2015, New GCU filed a Form 1023 with the IRS and sought a determination that it was qualified under Section 501(c)(3) of the Internal Revenue Code to operate as a nonprofit university. The Form 1023 was filed specifically in contemplation of the proposed transaction with GCE and contained extensive details regarding the terms of the proposed transaction between New GCU and GCE, including the terms of the proposed MSA and *the fact that Mr. Mueller would serve both as President of GCU and Chief Executive Officer of GCE*.[2]

In November 2015, the IRS issued its determination letter designating New GCU as a tax-exempt educational organization pursuant to Section 501(c)(3) of the Internal Revenue Code. While New GCU obtained this approval nearly three years ago during the pendency of the prior iteration of the transaction, the basic structure of the transaction as described in the Form 1023 is not different from the terms of the Transaction as consummated on July 1, 2018, and the terms of New GCU's governance structure, including Mr. Mueller's dual role, as well as the terms of the MSA, were described in detail.[3] On August 31, 2018, at GCU's request, the IRS issued an affirmation letter confirming GCU's status as a tax-exempt entity under Section 501(c)(3) of the Internal Revenue Code. A copy of the Form 1023, as filed with the IRS, the IRS determination letter, and the IRS affirmation letter are attached to this letter as Exhibits C, D, and E.

(d) ***Status of GCU with Other Governmental Authorities and Accrediting Bodies***. In addition to the IRS, HLC and the Arizona Board, we would also like to make the Department aware of

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[2] As with the HLC approval, the Form 1023 upon which the IRS based its 501(c)(3) determination noted that Mr. Mueller was, and would continue to serve as, a board member of New GCU. As noted in Note 1 above, Mr. Mueller resigned from that position in June 2018, prior to the final decision of the trustees to approve the Transaction. At that time, New GCU changed its governance documents to prohibit any individual who has a financial interest in GCE from serving on its board.

[3] The financial terms of the transaction have changed since the 2015 application. At that time, the third party valuation and transfer pricing studies that New GCU had initiated for purposes of informing the pricing of the acquisition of GCU and the terms of the MSA had not yet been completed. As further discussed below, we believe that the terms of the Transaction as closed on July 1, 2018, based on very recent valuation and transfer pricing studies, are more favorable to New GCU than the terms that were anticipated in 2015.

actions taken by other governmental authorities and accrediting bodies in response to the closing of the Transaction and GCU's operation as a nonprofit institution.

(i) Maricopa County, the county where GCU's campus is located, has granted GCU's claim for property tax exemption as a nonprofit educational organization under A.R.S. 42-11104 (see Exhibit F attached hereto).

(ii) GCU is now registered and approved as a "foreign ("domestic" in the case of Arizona) nonprofit corporation" in 45 states and the District of Columbia, with applications currently pending in 5 states that are expected to be approved in the coming weeks.

(iii) The NCAA now recognizes GCU as a nonprofit member institution with full authority to participate in the NCAA governance structure. Earlier this month, for example, GCU's Deputy Athletics Director and Senior Woman Administrator, Jamie Boggs, was appointed to serve on the NCAA Division I Council.

IV. The Department's September 10, 2018 Letter.

The Department's September 10, 2018 letter requests that we "provide the Department with a narrative explaining how this new structure and servicing arrangement warrants recognizing the institution's conversion to nonprofit status for purposes of the Title IV programs, with the identification of supporting documentation" and to "address the impact of the Master Services Agreement (and any ancillary agreements) on GCU's requested nonprofit status." The above recitation of the history of the transaction, the extensive review done by accrediting bodies and regulatory agencies, and the recognition of GCU's nonprofit status by HLC, the Arizona Board, the IRS, the NCAA, and other accreditors and state and local authorities, provides part of this explanation, and the documents attached as Exhibits A-F provide some of the supporting documentation. Nevertheless, we recognize the Department's position that it must make an independent determination as to whether to recognize GCU as a nonprofit institution for purposes of Title IV programs. For the reasons discussed below, we believe that GCU qualifies under the Department's regulations as a "nonprofit institution" and we request that the Department recognize it as such for purposes of Title IV programs.

(a) ***The Department's Definition of a "Nonprofit Institution."*** The Department's definition of a nonprofit institution is codified at 34 C.F.R. § 600.2, which defines a nonprofit institution as an institution that:

> *(1) Is owned and operated by one or more nonprofit corporations or associations, no part of the net earnings of which benefits any private shareholder or individual;*
>
> *(2) Is legally authorized to operate as a nonprofit organization by each State in which it is physically located; and*
>
> *(3) Is determined by the U.S. Internal Revenue Service to be an organization to which contributions are tax-deductible in accordance with section 501(c)(3) of the Internal Revenue Code (26 U.S.C. 501(c)(3)).*

On the surface, GCU meets each of these requirements: (i) it is owned and operated by a nonprofit corporation and none of its net earnings benefits any private shareholder or individual; (ii) GCU's physical campus, comprised of more than 270-acres in the heart of Phoenix, is located in Arizona and, as noted above, pursuant to its letter dated April 26, 2018, the Arizona Board has authorized GCU to operate as a nonprofit institution in that state, and Maricopa County has granted GCU's claim for property tax exemption as a nonprofit educational organization under A.R.S. § 42-11104, and (iii) pursuant to the IRS determination

letter dated November 9, 2015, which was affirmed by the IRS on August 31, 2018, the IRS determined that New GCU is an organization to which contributions are tax-deductible in accordance with section 501(c)(3) of the Internal Revenue Code (26 U.S.C. § 501(c)(3)).

To our knowledge, the Department has never published any Dear Colleague Letter or other generally applicable and publicly available guidance on any other factors that the Department would consider in assessing whether an institution qualifies as nonprofit entity for Title IV purposes beyond the three factors above. However, written decisions of the Department concerning other institutions that have sought status as a nonprofit institution for Title IV purposes do shed some light on factors that the Department may consider below the surface when ruling on an institution's request to be treated as a nonprofit institution. We understand that the factors most carefully scrutinized by the Department are:

- With respect to clause (i) of the definition above, whether the terms of the financial and contractual arrangements between the requesting institution and third parties effectively grant operational control of the institution to a third party or provide benefit or inurement to (e.g., by causing the net earnings of the nonprofit owner to benefit) private shareholders or individuals; and

- With respect to clause (iii) of the definition above, whether the IRS' determination that the requesting institution entity qualifies as a 501(c)(3) organization was made based on a full understanding of the facts and circumstances relevant to the Department's review, or whether the institution is being operated by a nonprofit entity that was formed for a different purpose and achieved its 501(c)(3) designation based on a different purpose and set of facts.

We submit below that both of those factors weigh heavily in favor of GCU's request to be recognized as a nonprofit institution for Title IV purposes.

(b) ***New GCU's governance structure and the terms of the Transaction and the ongoing agreements between New GCU and GCE make clear that GCU is both owned <u>and</u> operated by New GCU***. The governance structure of New GCU and its relationship to GCE are critical aspects of the Transaction, which we believe fully support the conclusion that New GCU, through its board of trustees, has appropriate authority over GCU and its operations that is not limited in any fashion by its governance documents, the financial terms of the Transaction, or the terms of the MSA.

(1) *Governance structure*. The board of trustees of New GCU and the board of directors of GCE are fully independent of one another and have no overlapping members. New GCU is a member nonprofit corporation. The sole member of New GCU is Grand Canyon University Foundation ("GCUF"). The members of the board of directors of GCUF are identical to the seven independent members of New GCU's board of trustees. GCE and its board have no involvement with or authority over New GCU's board and its decisions and as noted above, since the closing of the Transaction, the New GCU board, consisting entirely of independent members, has expanded its roster of independent members from four to seven. Further, New GCU's governing documents reflect that its board possesses and exercises the necessary legal power to establish and review the basic policies that govern the institution. In the exercise of their respective fiduciary duties, the boards of each of New GCU and GCE made independent decisions to retain Mr. Mueller in his positions as President of GCU and Chief Executive Officer of GCE, respectively, but each retains the full, independent authority to retain or terminate his services in the future (i.e., New GCU could choose to terminate Mr. Mueller as President of GCU without regard to his status at GCE, and vice versa). Further, as highlighted in the HLC Staff Summary quoted above, the terms of New GCU's bylaws and of the MSA limit Mr. Mueller's direct involvement in the day to day oversight of the relationship

with GCE: first, direct oversight is vested in a "Designee" appointed by each party (a position in which Mr. Mueller is ineligible to serve) and, second, from New GCU's side, management oversight of the MSA relationship is vested in a standing committee of the independent board of trustees designated as the MSA Committee (on which Mr. Mueller is ineligible to serve) which answers directly to the board of trustees (as to which Mr. Mueller is not a member).

(2) *Contractual terms*. In connection with the closing of the Transaction, the parties entered into the APA, the Credit Agreement and the MSA.

(A) APA and Credit Agreement. Under the APA, New GCU purchased the land and buildings comprising the GCU campus. In consideration for the purchase, it issued to GCE a secured promissory note governed by the terms of the Credit Agreement. Several aspects of the Credit Agreement are important to note as they relate to New GCU's control over the operations of GCU and the issue of whether any private shareholder or individual is receiving any portion of the net earnings of GCU.

- First, GCE has long been a party to a credit agreement with a syndicate of banks led by Bank of America. To ensure that their agreement reflected standard commercial terms for third party credit arrangements, New GCU and GCE agreed to use the Bank of America form of credit agreement in place with GCE as the foundation for the Credit Agreement between the parties. Subject to changes made to reflect the underlying deal between New GCU and GCE, the Credit Agreement tracks the Bank of America form, including as its relates to negative covenants and events of default. The rights granted to GCE as a secured lender under the Credit Agreement are well in line with customary terms of commercial credit agreements.

- Second, the purchase price New GCU paid for GCU reflects no goodwill. Rather, the purchase price was established as the lesser of the fair value of the tangible assets (as determined by third party appraisals commissioned by New GCU) or the book value of the tangible assets (land, improvements and personal property) sold plus $1 for all intangible assets sold.[4] In reality, the principal balance of the secured note payable by New GCU is significantly less than the fair value of the hard assets it acquired and substantially less (on the order of several hundred million dollars) than the combined value of the tangible and intangible assets it acquired. This element of the Transaction is entirely to the benefit of New GCU.

- Third, the secured note has a fixed interest rate that does not fluctuate with the profitability of New GCU. In establishing the applicable rate, the parties agreed that New GCU would commission a third party (in this case, Wells Fargo) to analyze the Transaction and recommend an interest rate range that it believed reflected fair market terms. The parties then negotiated the mid-point of this range as the rate to apply to the secured note. That rate is fixed at six percent (6%) for the life of the secured note.

[4] The referenced appraisals have been previously provided to the Department. The fact that New GCU owns and controls this immensely valuable real estate is further confirmed in the audited same-day balance sheet submitted to the Department on August 31, 2018.

(2) MSA. The structural terms of the MSA reflect that New GCU retains full control over all policy and academic decisions and substantial and significant rights to audit GCE's performance, seek modifications to the MSA, enforce its rights, and otherwise act as a fully independent counterparty on the contract. These terms are discussed in detail in the HLC Staff Report attached as Exhibit A. In addition, the financial terms of the MSA provide that New GCU will pay GCE 60% of its "University Adjusted Gross Revenue" (as that term is defined in the MSA). This percentage was agreed by the parties after consideration of the terms of publicly available services agreements between institutions and third parties, the level and scope of the services to be provided by GCE, and the results of a transfer pricing study commissioned by New GCU.[5] To protect New GCU against future changes in the services market that may impact the market price for third party services, the MSA allows New GCU to request that a new third party analysis be conducted and that the pricing be re-set after year ten of the initial term. In addition, the MSA includes terms, such as Section 18.2, that specifically provide that the parties will engage in additional negotiations to amend the MSA if the Board of Trustees of New GCU determines in good faith that the MSA may jeopardize the institution's accreditation, impair the institution's tax status, impair the institution's eligibility to participation in Title IV Programs or if an amendment is otherwise required to comply with applicable law. The process by which the MSA services were priced, and the terms of the MSA, were specifically established to ensure that New GCU pays a market rate for the services provided to GCE.

(c) ***No portion of the net earnings of New GCU inures to the benefit of any private shareholder or individual***. We are aware that, in other cases, the Department has determined that, notwithstanding an institution's nonprofit status, the terms of the institution's relationship with its former for-profit owner suggest that the former owner still benefits from the net earnings of the institution. This has been found where, for example, the former owner continues to own and lease to the institution the facilities at which the institution operates; where the terms of the note payable to the former owner require payments based on the net earnings of the institution; where the purchase price payable to the former owner reflects substantial goodwill and is not supported by an independent valuation or backed by real assets; or where the transaction documents contain negative covenants or other consent rights in favor of the former owner that effectively vest in the former owner the power to control the financial destiny of the institution. None of these factors exist here. In fact:

- Except for the three principal transaction documents – the APA, the Credit Agreement, and the MSA – and a Facilities Services Agreement, copies of which have all been provided to the Department, there are no other agreements between New GCU and GCE.
- New GCU acquired all of the land, buildings and personal property that comprise the GCU campus and has complete control over those assets. The GCU campus today consists of more than 270 acres in the heart of Phoenix, with classroom facilities, a library, administration buildings, dormitories, parking structures, a performing arts center, recreational and NCAA athletic facilities, and other improvements, nearly all of which have been built in the last eight years at a cost of more than $1.0 billion.
- The financing terms negotiated and agreed to under the Credit Agreement reflect a straight debt obligation with a fixed interest rate within a range recommended by an independent third party and other customary commercial terms modeled on GCE's existing market-based credit agreement. Neither the interest rate, nor the principal balance of the note, change based on the profitability of New GCU.

[5] The referenced transfer pricing study authored by Deloitte LLP has been previously provided to the Department. We emphasize that Deloitte was engaged by and owed its duties to New GCU.

- The revenue share rate under the MSA was negotiated and agreed to in large part based on a third party transfer pricing study and does not change based on the profitability of New GCU.

- The projected revenue net of expenses and revenue net of expenses after interest of New GCU in its first fiscal year of operations as a stand-alone nonprofit institution are projected to be $79.2 million and $20.2 million, respectively, increasing to $123.1 million and $60.8 million, respectively, by its fifth year of operations. This reflects a compound annual growth rate of New GCU's revenue net of expenses of 9.2% and of its revenue net of expenses after interest of 25.3%. All of those earnings are for the benefit of New GCU, and New GCU's board of trustees alone has the authority to determine how New GCU's earnings are utilized.

- GCE is a publicly traded company whose common stock is principally held by funds managed by institutional investors such as Vanguard, Fidelity and BlackRock. No individual holds or controls more than 2.0% of its outstanding shares. Accordingly, control of GCE resides in its board of directors, which is made up of a majority of members who qualify as "independent" under the applicable rules and regulations of the Securities and Exchange Commission and the Nasdaq listing standards, none of whom serve on the board of trustees of New GCU and none of whom (other than Mr. Mueller) have any relationship – employment, economic or otherwise – with New GCU. In addition, Article I, Section 3(a) of New GCU's Bylaws precludes an individual who has a financial interest in GCE from serving as a member of the board of trustees of New GCU.

We believe the foregoing amply demonstrates that New GCU, both on paper and in fact, satisfy the first element of the Department's definition of a nonprofit institution.

(d) ***New GCU's Section 501(c)(3) determination should carry weight since it was issued on the specific basis of the transaction with GCU***. In its definition of a nonprofit entity under Section 501(c)(3) of the Internal Revenue Code, the IRS applies the same net earnings standard, couched in terms of "inurement." The critical definition at 26 U.S.C. § 501(c)(3) refers to:

> *A Corporation, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.*

Because the standard applied by the IRS is substantively the same as the Department's, and because the IRS is the agency tasked with determining an entity's 501(c)(3) status, we believe that, under ordinary circumstances, the IRS's determination that an institution qualifies as a 501(c)(3) entity should be given appropriate deference by the Department in making its decision. We do understand, however, that the Department has chosen in certain cases to discount the value it places on a 501(c)(3) determination, and substitute its own independent judgment, if it concludes that the IRS issued the determination letter to a

nonprofit entity at a time when the nonprofit entity's stated purpose and its historical operations involved matters other than operating a university and delivering educational services. Again, this is not the case with New GCU.

New GCU filed its Form 1023 application in 2015 and it specifically focused the application around its then-pending transaction with GCE. As part of its Form 1023, New GCU submitted substantially complete drafts of the transaction documents, including the APA and MSA, and highlighted Mr. Mueller's proposed dual role. While the Transaction that closed on July 1, 2018 differs in some respects from the transaction described in the Form 1023 – for example, Mr. Mueller no longer serves on both boards, and the purchase consideration was paid in the form of a note rather than the cash proceeds of a bond offering – the stated purpose of New GCU and the substance of its application as reviewed by the IRS do not differ from the New GCU in operation today. Because New GCU's Form 1023 squarely addressed the transaction and the IRS granted the 501(c)(3) determination letter following its review of that application, we believe that its determination should be given great weight and that there is no reasonable basis upon which to discount this determination or take a contrary view. Again, the 2015 IRS documents, plus the 2018 IRS affirmation, are at Exhibits C, D and E.

(e) Impact of Other Transactions. The Department's September 10, 2018 letter requests that we discuss other service provider transactions upon which we are relying in making our request for recognition of GCU as a nonprofit institution. We believe that here it is valuable to provide a brief history of GCU. While much of what we say here may be familiar to you, we think it is important in setting the context and understanding the distinctive reasons why New GCU and GCE consummated the Transaction and why we believe that recognition of GCU as a nonprofit institution is warranted.

GCU was founded in Prescott, Arizona in 1949 as a traditional, private, nonprofit college under the name Grand Canyon College and moved to its existing campus in Phoenix, Arizona in 1951. Established as a Baptist-affiliated institution with a strong emphasis on religious studies, the school initially focused on offering bachelor's degree programs in education. Over the years, the school expanded its curricula to include programs in the sciences, nursing, business, music, and arts. The college obtained regional accreditation in 1968 from the Commission on Institutions of Higher Education, North Central Association of Colleges and Schools, the predecessor to HLC, and began offering nursing programs and master's degree programs in education and business in the 1980s. In 1989, it achieved university status and became Grand Canyon University. In early 2000, it discontinued its Baptist affiliation and became an interdenominational Christian university.

GCU's student enrollment during most of the period after it became a university was less than 2,000 students with the vast majority of these students studying to be teachers or nurses. Even with what was considered a reasonable tuition rate for a private university, GCU struggled to compete with the heavily tax-subsidized state universities in Arizona and other well-established private universities in California and Texas. In early 2000, GCU's Board of Trustees decided to invest in a student union, a new dormitory and additional classrooms with the hopes that this would help increase student enrollment. Unfortunately, it did not. Fundraising efforts were initially successful in keeping GCU operating but, by late 2003, GCU was over $20 million in debt and teetering on the verge of insolvency. Without a significant donor base, GCU's only alternative to bankruptcy was to sell the school to a group of investors who quickly implemented a new business plan that included selling and leasing back the campus and instituting online programs designed for working adults. During the period between 2004 and mid-2008, GCU continued to focus on its financial stability and growth primarily through online education while the ground campus continued to lose money and ground campus enrollment remained stagnant. In June 2008, during the process leading to GCE's initial public offering in November 2008, the school hired a new management team led by President Brian Mueller and Executive Vice President Dr. Stan Meyer.

Beginning in 2009, the management team implemented a strategy focused on reinvigorating GCU's ground campus and creating a university that, in many respects, would be indistinguishable from the traditional, private, nonprofit universities with which it competed. Since repurchasing the campus in 2009, GCU has nearly tripled the campus footprint to over 270 acres and has invested over $1.0 billion in educational infrastructure including new classrooms, dormitories, technology, and athletic and parking facilities. For the fall of 2018, GCU has over 20,000 students enrolled on its ground campus and over 70,000 non-traditional students attending online. The growth has been accomplished with tuition rates that are comparable to tuition rates for in-state students at state universities and that are often 1/3 the rates charged by private nonprofit universities.

While other universities raise tuition every year as a matter of course, GCU has accomplished its astounding growth *without raising on-campus tuition in the last decade*. The painstaking re-engineering of GCU has made a private, Christian education affordable for many who previously could only dream of such an opportunity. Maintaining affordability is critical to New GCU's mission and one of the primary objectives of the Transaction is ensuring that New GCU can maintain this exceptional record and commitment which benefits the public by ensuring that higher education is accessible and affordable to all socioeconomic classes of Americans.

Today, nearly half of GCU's campus students are enrolled in STEM programs, primarily in health sciences and the majority of its working adult students are pursuing graduate degrees or degree completion programs such as the Registered Nurse to Bachelors in Nursing. Moreover, in keeping with its mission of preparing students with the skills and knowledge needed in the contemporary job market, and in light of Bureau of Labor Statistics and Burning Glass Technologies reports on the growing need for STEM-field employees, GCU commenced programs in engineering and technology in the last four years with a stated goal of having over 70% of campus students studying in the STEM areas within the next five years. The public derives great benefit from the growth of these programs as these are critical areas of need for the community at large. One of the primary benefits of the Transaction is that the decreased tax burden on GCU, along with new access to charitable giving and grant opportunities, will aid GCU in its continued efforts to reinvest in these critical programs for the public's benefit.

Along with the significant improvements in the academic experience at GCU, GCU re-ignited its performing arts programs in theatre, music, and dance in 2010 and these programs are winning local awards for their quality. GCU's athletic program sponsors 21 intercollegiate sports. In 2013, GCU made the leap to NCAA Division I athletics when it was invited to join the Western Athletic Conference. This move has elevated the profile of GCU and its student-athletes to even greater levels – in the 2017-2018 season, for example, the University's men's basketball team played games at Louisville and Illinois, played in front of sold out crowds of greater than 7,000 at almost all of its home games, and was one win away from receiving an automatic bid to the NCAA Division I basketball tournament before losing in the WAC conference finals. In addition, campus life is rich with concerts, intramural sports and over 100 student clubs and organizations that are directly supported and managed by GCU.

In the surrounding community, GCU lives out its mission through its community involvement and efforts to perform public good. GCU is involved in hundreds of community events and projects throughout the year. Two of GCU's most prominent public outreach programs involve Habitat for Humanity and the GCU Learning Lounge:

- *Habitat for Humanity*: GCU has a long-standing partnership over several years with Habitat for Humanity to renovate and rebuild over 700 homes in the surrounding neighborhood. GCU's students, faculty and staff provide the volunteer labor to complete the repairs, which are funded by

contributions from faculty and staff. In the past three years, GCU has raised over $1.0 million and its students, faculty and staff have helped renovate over 200 homes to date.

- *GCU Learning Lounge*: In 2013, GCU launched an ambitious partnership with nearby Alhambra High School through which GCU students provide after-school tutoring and mentoring to Alhambra High School students. The program's goal is to dramatically raise Alhambra's graduation rates and test scores and to better prepare its students, many of whom come from disadvantaged minority households, for the rigors of college study. In a short period of time, this partnership has achieved results with Alhambra improving its state rating from a "D" to just ten points shy of a "B". In 2016 Alhambra High School was awarded the Beat the Odds Gold award from the Arizona Department of Education by demonstrating improved AIMS scores over three years, in addition to other criteria. The program has now been expanded to include over 1,000 GCU students volunteering to provide tutoring and mentoring in 90 neighboring schools.

In addition to the above-described projects, GCU holds popular annual gift drives at Christmas and Easter to help brighten those seasons for many underprivileged families. GCU further supports its surrounding neighborhoods via its long-standing Serve the City and Canyon Kids programs. Another initiative, 12 Months of Service, identifies specific needs in the community (such as graffiti abatement) and focuses volunteer support from students, faculty and staff to meet those needs on a monthly basis.

In short, GCU is a comprehensive liberal-arts institution that offers over 220 degree and certification programs across nine colleges, along with established fine arts programs, NCAA Division I athletics, and a thriving campus. GCU is virtually indistinguishable from other leading faith-based institutions, such as Baylor University, DePaul University, St. John's University and Marquette University. The average incoming grade point average of GCU's first year traditional ground students is over 3.5. Over 70% of GCU's online students are studying in graduate or degree completer bachelor programs. GCU's graduation rates, cohort default rates, and other university metrics are now in many cases equal to or better than rates found at public universities and faith-based private universities. GCU's most recent official three-year cohort default rate, for example, is 6.1%. Based on current admissions trends and under the ownership of New GCU, GCU plans to continue its investment in its ground campus in order to grow traditional enrollment to 25,000 students over the next five years and achieve growth in its online student body of approximately 7 percent per year over that period. Improved academics, partnerships with the City of Phoenix and surrounding neighborhoods, and extensive community outreach efforts and servant leadership will continue to be hallmarks of GCU.

Despite GCU's indisputable success, and its strong belief that such success was poised to continue, GCU's board of trustees believed that it was in the best interest of GCU's students, faculty, staff, and community to return the university to its historical status as a nonprofit institution. The reality was that operating as a for-profit university put GCU at a significant disadvantage relative to the universities it competes against. Prior to the Transaction, as a for-profit entity, GCE paid substantial amounts in income and property taxes – nearly $100.0 million in 2017 – while its competitors paid none and, with respect to its state university peers, some of its competitors received additional benefits in the form of state subsidies. In addition, among other factors, GCU was ineligible to receive government research grants or charitable donations, was prohibited from recruiting in school districts in various states, and was treated by the NCAA as a non-voting member.

Perhaps most importantly, however, any perceived disadvantages to GCU in operating as a for-profit entity do not extend to regulatory disadvantages. To be clear, the Transaction was in no way done to avoid regulations applicable to for-profit universities as GCU's regulatory performance on factors such as its composite score and cohort default rate, as well on regulations applicable only to for-profits such as the

90/10 ratio and gainful employment metrics, have far exceeded the standards applicable to schools generally or for-profits in particular. In addition, GCU has been subjected to regular government oversight and hefty regulatory compliance efforts for more than ten (10) years and its track record, especially in recent years, has been exemplary. In the last two years alone, GCU has been subjected to reviews by six major institutional and specialized accrediting bodies. GCU completed those comprehensive reviews with 100 percent compliance, including a visit from HLC in which GCU's accreditation was reaffirmed for an additional 10 years, which is the maximum extension of accreditation the HLC offers. In addition, GCU recently received the maximum 10-year accreditation from the Commission on Collegiate Nursing Education; completed the four-year transition to NCAA Division I athletics; completed a Veterans Administration audit with no findings; received a 10-year reaccreditation from the Accreditation Council for Business Schools and Programs; and has been granted associate membership of the Association of Theological Schools as it completes the process for full accreditation. Simply put, *regulatory considerations were not a factor and played no role in the decision by New GCU to consummate the Transaction*.

In reality, GCU first developed the proposed structure for this transaction *in the fall of 2010* and before any "nonprofit conversion" of which we are aware had occurred. GCU management traveled to Washington, D.C. and presented the structure in person to Department representatives *in June 2011*. It made application to the HLC for a transaction based on this structure in *2015-2016* and then again in *2017-2018*.

We cite this brief history to demonstrate that GCU has pursued this transaction, in this structure, for a long time and for reasons having nothing to do with salvaging a failing business model, a desire to avoid regulatory compliance, or imitating another "conversion" transaction. Returning GCU to its nonprofit roots has long been a goal of GCU's board of trustees and management because they have long believed that such an outcome would be in the best long-term interests of the institution, its students, faculty, staff and the public.

In developing the financial terms of the MSA, New GCU and GCE and their respective advisors of course conducted market research, reviewing the terms of as many publicly available higher education servicing agreements as could be obtained. And while those agreements, to the extent available, informed this financial analysis, New GCU did not rely on them per se but on the transfer pricing study conducted by Deloitte on behalf of New GCU (referred to above), which concluded that the pricing terms of the MSA were fair to New GCU. Furthermore, New GCU relied upon personal property, real property, and intangible asset valuations performed by independent, third party experts, along with the advice and counsel of sophisticated outside corporate, regulatory and tax counsel, and independent, third party financial experts, such as Wells Fargo, to ensure that all terms of the Transaction were fair and reasonable from an independent commercial standpoint. New GCU did not rely, at all, on any other agreements with respect to the governance structure of its board and management or as it relates to the MSA. Rather, those structures were developed based on careful analysis of IRS regulations and HLC accrediting standards and with advice of outside counsel with expertise in nonprofit matters (including outside counsel hired by HLC to review these structures), as well as a laser-like focus on ensuring that the resulting structure and financial terms placed GCU in the best possible position to succeed on its own and continue to pursue its mission for the benefit of its students, faculty, staff and the public. As such, GCU believes that comparisons to the Kaplan transaction or any other example are not relevant. Rather, it believes that the Transaction, and the completely transparent and aboveboard approach that both New GCU and GCE took in engaging with one another, their respective regulators and other stakeholders, stands on its own.

V. **Conclusion**.

We sincerely hope that the Department finds this letter to be responsive to its request, and that the Department concludes that GCU warrants recognition as a nonprofit institution for Title IV purposes.

Thank you for your attention, and please let us know if you have additional questions.

Sincerely,

Jonathon C. Glass

Counsel to Grand Canyon University

Enclosures